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U.S. SENATE REPUBLICAN POLICY COMMITTEE

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Enormous Government Expansion Bill is Dangerous Approach to Help Our Economy

Executive Summary

- Contrary to the assertions of prominent Democrats in Congress, there is no consensus among economists that massive expansion of government is necessary or desirable to fix our struggling economy.
- Spending by governments may be useful in softening economic downturns; however, the long-run repercussions of the massive spending will outweigh the short-run benefits.
- Much of the "stimulus spending" the H.R. 1 substitute is poorly targeted or poorly timed to help the economy in 2009 or 2010. CBO estimates that only 12% of the appropriated money spends out this year.
- Much more of this spending bill is a down-payment on unnecessary long-run policies, long advocated for by Congressional Democrats.
- The true threats to our economy lie in the housing and the financial sector; spending hundreds of billions of dollars on expanding the size and reach of the government is irresponsible and dangerous.
- The unsustainable fiscal path caused by our unfunded entitlement programs is still looming, and "trillion-dollar deficits for years to come" will only make the crisis worse.

"Organized public works, at home and abroad, may be the right cure for a chronic tendency to a deficiency of effective demand. But they are not capable of sufficiently rapid organization (and above all they cannot be reversed or undone at a later date), to be the most serviceable instrument for the prevention of the trade cycle."

John Maynard Keynes, *Collected Writings, Volume XXVII*

"We can build roads instead of factories, but fiscal stimulus can't help us to build more of both."

John Cochran, "Fiscal Stimulus, Fiscal Inflation, or Fiscal Fallacies"

Contrary to the assertions of prominent Democrats in Congress, there is no consensus among economists that massive expansion of government is necessary or desirable

The United States economy is undoubtedly in bad shape. The financial crisis that began in the U.S. with sharp reversals in residential real estate price appreciation quickly spread and has infected the real economy from Kansas to Korea.

Unemployment has climbed from 4.4% to 7.2% in only 21 months and 2.9 million Americans have lost their jobs. The National Bureau of Economic Research declared in December the U.S. has been in recession since December 2007; at 13 months this is already the longest post-World War II recession. Consumer spending, which makes up over 70% of the economy, has declined for six consecutive months. Home prices have declined in all 20 metro markets tracked by the widely used Case-Shiller index, which shows a national price decline of 25% since the peak in May 2006. Banks have faced massive losses on mortgage-backed securities, and further losses are likely as homeowners continue to see their home values diminish and foreclosures escalate.

Most worrisome is that the Consumer Price Index has declined on a monthly basis for the past five months, suggesting the possibility of deflation. The United States has not seen a banking crisis of this magnitude and faced the possibility of sustained deflation since the 1930's. Then, thousands of banks failed and the misguided action of policy makers exacerbated the problem by restricting the money supply, leading to a sustained period of high unemployment and low economic activity that came to be known as the Great Depression.

There is no clear path out of the current slowdown. While Congressional Democrats have embraced the advice of economists who believe that a large jolt of government spending is necessary to support job creation over the next two years, many of these economists fail to acknowledge the enormous uncertainty and limited experiences they are drawing conclusions from. There is no clear consensus in the economic profession on the effect of fiscal stimulus, and many prominent economists have expressed skepticism or outright opposition to such a plan.

Skeptical economists

As proponents argue, government spending can have a salutary effect on the economy in the short-run. However, the form of that stimulus matters greatly, and a large number of economists have questioned both the timing and the effectiveness of specific proposals for stimulus.

Claims that there is a consensus amongst economists are disingenuous. The major problem with the arguments made by proponents of the Democrats' stimulus is that they have offered nothing in the way of an analytical justification that the long-term costs of massively increasing the deficit with increased government spending is outweighed by the short-run costs of government fiscal inaction in the face of a banking-crisis driven economic slowdown. They also have not compellingly made the case that the specific proposals envisioned by Congress are, in fact, the best form of short-run stimulus.

Many economists have questioned the specific proposals we have seen:

- **Robert Barro, Harvard:** "On the spending side, the main point is that we should not be considering massive public-works programs that do not pass muster from the perspective of cost-benefit analysis."[1]

- **Greg Mankiw, Harvard:** "If the stimulus package takes the form of bridges to nowhere, a result could be economic expansion as measured by standard statistics but little increase in economic well-being."[2]

- **Thomas Sargent, New York University:** "The calculations that I have seen supporting the stimulus package are back-of-the-envelope ones that ignore what we have learned in the last 60 years of macroeconomic research."[3]

And many economists question the fundamental premise that stimulus can help the economy. This group argues that since any short term spending will have to be paid off in the long run, the government cannot jolt the economy out of a slump without facing a day of reckoning down the road.

- **Eugene Fama, University of Chicago:** "The problem is simple: bailouts and stimulus plans are funded by issuing more government debt. (The money must come from somewhere!) The added debt absorbs savings that would otherwise go to private investment. In the end, despite the existence of idle resources, bailouts and stimulus plans do not add to current resources in use. They just move resources from one use to another."[4]

- **John Cochran, University of Chicago:** "First, if money is not going to be printed, it has to come from somewhere. If the government borrows a dollar from you, that is a dollar that you do not spend, or that you do not lend to a company to spend on new investment. Every dollar of increased government spending must correspond to one less dollar of private spending. Jobs created by stimulus spending are offset by jobs lost from the decline in private spending. We can build roads instead of factories, but fiscal stimulus can't help us to build more of both."[5]

- **Nobel laureate Gary Becker:** "For one thing, the true value of these government programs may be limited because they will be put together hastily, and are likely to contain a lot of political pork and other inefficiencies. For another thing, with unemployment at 7% to 8% of the labor force, it is impossible to target effective spending programs that primarily utilize unemployed workers, or underemployed capital. Spending on infrastructure, and especially on health, energy, and education, will mainly attract employed persons from other activities to the activities stimulated by the government spending. The net job creation from these and related spending is likely to

[1] Barro, Robert J. "Government Spending Is No Free Lunch." *The Wall Street Journal*, 22 January 2009.
[2] Mankiw, N. Gregory. "Is Government Spending Too Easy an Answer?" *The New York Times*, 10 January 2009.
[3] "The Stimulus Rush." *The Chicago Tribune*, 13 January 2009.
[4] Fama, Eugene F. "Bailouts and Stimulus Plans." Fama/French Forum: Hosted by Dimensional, 13 January 2009.
[5] Cochran, John H. "Fiscal Stimulus, Fiscal Inflation, or Fiscal Fallacies? Version 2.2." University of Chicago Booth School of Business. 27 January 2009.

be rather small. In addition, if the private activities crowded out are more valuable than the activities hastily stimulated by this plan, the value of the increase in employment and GDP could be very small, even negative."[6]

- **Willem Buiter, Former Chief Economist of the European Bank for Reconstruction and Development:** "I don't believe the US has either the external credibility or the goodwill capital any longer to ask, Oliver Twist-like, for a little more leeway, a little more latitude… There will, before long (my best guess is between two and five years from now) be a global dumping of U.S. dollar assets, including U.S. government assets."[7]

Because of the United States' extreme reliance on foreign funding of sovereign debt and the reliance of much of the rest of the world on U.S. debt and the dollar as a reserve currency, such a dumping of dollar assets would be disastrous for the U.S. and world economy.

Fiscal action may be useful in mitigating economic downturns…

Both the logic and the evidence for a fiscal stimulus seem to make sense at first glance. There are two main justifications for fiscal stimulus. As the largest player in the world economy, the U.S. government has substantial borrowing and spending power. Traditional Keynesian economic theory tells us that when spending by businesses and consumers dries up, the government can spend money or lower taxes to encourage economic activity in the short run. Two estimates by Mark Zandi of economy.com and Council of Economic Advisers Chair Christina Romer and Vice President Biden's Chief Economist Jared Bernstein have argued that the effect of stimulus could be quite profound in supporting economic growth in the short run.[8, 9] However, their papers rely on unproven estimates of the multiplier effect of government spending and unrealistic expectations of short-run interest rates.

Stimulating Demand

A paper touted by stimulus advocates from the Peterson Institute provides a cross-country sampling of fiscal expansions in major OECD countries.[10] The results across these 37 fiscal expansions are mixed: in several cases, large fiscal expansions were followed by one or more years of negative GDP growth. One of the largest expansions studied, in the United Kingdom in 1992, applied additional deficit spending of 4.0 percent of GDP; this resulted in same year GDP growth of -0.5 percent and the next year of -2.0 percent.[11] In Japan, although a large spending program launched in 1995 and a large personal income tax cut in 1994 were perhaps effective at boosting incomes and employment in 1996, the effects were not sustained, and Japan is left with

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[6] Becker, Gary. "On the Obama Stimulus Plan." The Becker-Posner Blog, 11 January 2009.
[7] Buiter, Willem. "Can the US economy afford a Keynesian stimulus?" *Financial Times* 5 January 2009.
[8] Bernstein, Jared and Romer, Christina. "The Job Impact of the American Recovery and Reinvestment Plan." The Council of Economic Advisers and the Office of the Vice President-Elect. 9 January 2009.
[9] Zandi, Mark. "The Economic Impact of a $750 Billion Fiscal Stimulus Package," Economy.com, 6 January 2009.
[10] Posen, Adam S. "Fiscal Policy Works When it is Tried." Restoring Japan's Economic Growth. Washington DC 1998.
[11] This sampling is of limited usefulness in predicting the effects of a fiscal stimulus in the United States because it does not control for a variety of other factors that could have expanded GDP following a fiscal shock. Moreover, none of the previous stimuli that were studied are as large as the roughly 6.2-percentage point of GDP shock the Obama Administration is contemplating.

what one commentator described as a “construction state… in some respects akin to the military-industrial complex in cold-war America (or the Soviet Union), sucking in the country's wealth, consuming it inefficiently, growing like a cancer and bequeathing both fiscal crisis and environmental devastation."[12]

Should such a massive spending program be tried and fail in the United States, the country will see very little in the way of increased national income growth but will be left with an ever-larger deficit as a share of GDP and an ever growing constituency lining up at the federal trough for the specific programs Congress chooses to fund. This is especially troubling given the complete lack of serious cost-benefit analysis provided so far by stimulus supporters or even the budget justifications that are required by agencies as part of the normal appropriations process. A typical cost-justification for spending was offered by the House Committee on Appropriations, which argued that “for every dollar invested in broadband the economy sees a ten-fold return on that investment.”[13] If that were the case and there were no diminishing returns the U.S. should invest every dollar it has in broadband and watch the economy expand 100 percent.

Monetary Policy

The second justification for spending massive amounts of federal money right now is that the ability of the Federal Reserve to stimulate the economy has reached the end of its effectiveness. This is known as a “liquidity trap,” which theoretically occurs when the Fed’s primary tool, setting interest rates, is no longer useful because they cannot go lower than zero. Proponents of this view discount innovations in monetary policy over the last fifteen years, begun in Japan, that introduced a new set of tools for a central bank when interest rates are zero. These new tools creatively employ the Fed’s power to buy longer-term assets and print money.

Federal Reserve Chairman Ben Bernanke has clearly outlined these policy options throughout his tenure on the Federal Reserve Board. In a speech on January 13th, Chairman Bernanke said, “…I believe that the Fed still has powerful tools at its disposal to fight the financial crisis and the economic downturn, even though the overnight federal funds rate cannot be reduced meaningfully further.”[14] Drawing on his own research and the experience of Japan in the 1990’s and early 2000’s, Chairman Bernanke outlined measures beyond the zero interest rate that could be taken to stimulate the economy:

- Communicate credibly that the Federal Reserve is committed to keeping interest rates low for as long as necessary to fight deflation and stimulate economic activity;
- Expand the normal scope of Federal Reserve operations to target not just the short-term interest rates but to purchase longer-term securities such as five and ten year Treasury notes, lowering interest rates throughout the term structure;
- Drastically increase the balance sheet of the Federal Reserve to expand the money supply and ensure that sufficient liquidity exists for borrowers and investors.

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[12] Shlaes, Amity. “The Perils of a Cement Tsunami.” *The Washington Post*, 10 December 2008.
[13] “The American Recovery and Reinvestment Act of 2009: Discussion Draft” 111th Congress. 2009 January.
[14] Bernanke, Ben. “The Crisis and the Policy Response.” Speech at the Stamp Lecture at the London School of Economics. 13 January 2009.

As early as 2002, in a speech entitled "Deflation: Making Sure 'It' Doesn't Happen Here," he communicated a similar set of policy prescriptions the Fed could engage in should it be faced with a deflationary recession. In that speech Bernanke assured "that U.S. policymakers have the tools they need to prevent, and, if necessary, to cure a deflationary recession in the United States."[15]

With its policy statement of December 16th, the Fed committed to fighting deflation by holding interest rates low for as long as it takes and targeting longer-term interest rates. The Fed has already begun a massive and unprecedented expansion of its balance sheet, expanding the monetary base by nearly a trillion dollars in the last five months.[16] Reserve Bank Credit, a rough measure of the support the Fed has provided to financial markets, has increased from $800 billion as recently as July of this year to $2.1 trillion as of January 15th.[17] This means the Fed has extended more than $1.2 trillion in credit over the last seven months.

Some press reports have estimated the total amount of federal government support so far in this financial crisis to be more than $7 trillion.[18] This amount includes money the federal government has pledged to insure against losses, money the federal government has committed to specific institutions in exchange for ownership stakes or warrants, and very large loans the federal government has made available to the financial industry. These are important and unprecedented tools of monetary policy and their consequences are unpredictable. Normally, an expansion of Federal Reserve credit results in inflation: such a massive increase when faced with a deflationary threat is justified but we have no evidence to infer what the consequences of these new, liberally used tools of monetary policy will be.

These tools are significant because not only are they relatively new innovations in central banking but they have also been deployed relatively quickly. In the Japanese experience the central bank was slow to recognize the problem and slow to implement central bank innovations that could have made a difference much earlier. In less than one year of response the monetary authorities of the United States have done more right and less wrong than the Japanese did over the entire 1990's.

It took the Federal Reserve only 16 months to lower the primary credit rate 575 basis points from 6.25% to 0.50% in December 2008. In contrast, it took the Japanese authorities 41 months to lower the discount rate 400 basis points from 4.5% to 0.5% in September 1995. By this time Japan was in a prolonged slump, and the wrong fiscal and monetary policies did not help it recover.

…however, the long-run costs may outweigh the short-run benefits

The result of any deficit-financed spending would be a short-term increase in employment as the government hires workers to implement their chosen projects, and higher headline GDP growth as increased government spending gets added to the economy and that government spending

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[15] Bernanke, Ben. "Deflation: Making Sure "It" Doesn't Happen Here." Speech before the National Economists Club, Washington D.C. 21 November 2002.
[16] Series: BASE, St. Louis Adjusted Monetary Base. Economic Research: Federal Reserve Bank of St. Louis.
[17] Factors Affecting Reserve Balances. Federal Reserve Statistical Release. 29 January 2009.
[18] "Tracking the Bailout: The Government's Commitments." *The New York Times*, 26 November 2008.

generates ancillary economic activity. For example, if the government decides to build a bridge between two cities, employment would be increased as contractors are hired to work on the bridge, economic activity is increased as those firms and workers purchase equipment, clothing, and food to do their jobs, and national income will go up in the short-term.

However, this is not the end of the story. Because the United States has run fiscal deficits since 2001, the money to fund these projects has to be borrowed from elsewhere in the economy. In recent years the United States has borrowed massive amounts of money from foreigners at relatively low rates. Since 2001, all U.S. liabilities to foreigners (including private liabilities) have increased $5.1 trillion, a 187% increase. In that time, over $2.5 trillion has been added to the national debt held by the public, a 75 percent increase.[19] The debt limit has been raised 7 times. Due to the slowdown in economic activity and the actions taken to fight the 2008 financial crisis, the 2009 projected deficit for next year is $1.2 trillion, or 8.3 percent of GDP. This is a 5.1 percentage point increase in the deficit from 2008, and represents $565 billion in additional spending by the federal government.[20] The projected deficit in 2009 is larger than the entire amount spent by the government on discretionary programs in 2008, and the increase in the deficit from 2008 to 2009 is almost equal in size to all of the discretionary outlays of the United States in 1999.[21]

The Democrats' spending plan now calls for even higher deficits for an indefinite amount of time; President Obama characterized it as "trillion-dollar deficits for years to come."[22] Allan Sinai of Decision Economics estimates deficit spending of this magnitude will result in debt/GDP ratios of over 94% by 2016.[23] The only other time the United States has experienced a debt/GDP ratio that high was during World War II, a time of great domestic deprivation and sacrifice when Americans planted victory gardens in their neighborhoods to conserve food and massive publicity drives were mounted to get average Americans to buy bonds to fund the debt-financed war.

President Obama has warned the American people that the current outlook is so desperate that "we could lose a generation of potential." And he is correct. **However, though the benefits of fiscal stimulus are often considered against the costs of doing nothing, nowhere are the benefits of these massive spending programs weighed against the long-term costs and the very real potential for a seriously diminished appetite for United States sovereign debt.** Economist Jeffery Sachs recently wrote that "without a sound medium-term fiscal framework, the stimulus package can easily do more harm than good, since the prospect of trillion-dollar-plus deficits as far as the eye can see will weigh heavily on the confidence of consumers and businesses, and thereby undermine even the short-term benefits of the stimulus package."[24]

New evidence shows that even without a large spending program, the United States is already in a troublesome club of nations, as "a high incidence of global banking crises has historically been

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[19] Selected U.S. Liabilities to Foreigners, International Financial Statistics, Table IFS 2, Treasury, December 2008.
[20] Congressional Budget Office (CBO): The Budget and Economic Outlook, Fiscal Years 2009 to 2019, 8 January 2009.
[21] CBO: Outlays for Major Spending Categories, 1969-2008, Historical Tables of the Budget, F-5.
[22] Montgomery, Lori. "Obama Predicts Years of Deficits Over $1 Trillion." *The Washington Post*, 7 January 2009.
[23] *Macroeconomic Policy Challenges and Choices in a Time of Crises*, Allen Sinai, presented at the Andew F. Brimmer Policy forum, International Banking, Economics, and Finanice Association Session, January 9, 2009.
[24] "The Stimulus is a Fiscal Straitjacket," Jeffrey Sachs, *Financial Times*, 27 January 2009.

associated with a high incidence of sovereign defaults of external debt."[25] United States debt is currently rated AAA by the major rating agencies, the same agencies that had high ratings on many of the U.S.'s largest banks and insurance companies as recently as last year. U.S. short-term debt is yielding near 0.0% as financial institutions worldwide are bidding down interest rates to historic lows. For the time being, this makes the cost of borrowed funds to the U.S. very low, but it cannot last. Not only is the high level of debt/GDP ratio cause for concern, the massive and rapid increase in the debt leaves one wondering how all that extra borrowing will be financed in a very short period of time.

The United States is already on an unsustainable course for the future. The Congressional Budget Office has frequently warned, in increasingly dire terms, of the costs of the fiscal cliff the United States is headed towards due to the growing demands of its two largest entitlement programs, Social Security and Medicare.

Without either eliminating trillions of dollars in promised spending or massively expanding the federal government's share of GDP, these looming obligations will bankrupt this country. U.S. debt is currently cheap to finance as the U.S. government is currently the only issuer of financial instruments broadly trusted by financial markets. As major investors start to look for more attractive returns on investment elsewhere, the costs of borrowing for the U.S. government will go up. Recent data from the U.S. Treasury show that foreigners were net sellers of U.S. securities in November, an extreme rarity in recent years.[26] On net, foreigners sold $22.9 billion in November, already calling into question the Treasury's ability to finance $144 billion worth of Treasury auctions scheduled for the next two weeks.[27, 28] Spreads on credit default swaps on United States government debt, a measure of the perceived likelihood of default, though still low have risen to historic highs since last summer.[29]

When the era of easy money is over, the era of hard choices will begin.

In the words of Office of Management and Budget Director Orszag: "If we fail to put the nation on a sounder fiscal course. . . we will ultimately reach a point where investors [will] lose confidence and no longer be as willing to purchase Treasury debt at anything but exorbitant interest rates."[30] Unnecessarily adding $800 billion to the deficit is reckless and could bring our ultimate day of reckoning closer. To the extent fiscal stimulus is necessary and desirable, for such a massive increase in the deficit to be perceived by bond markets as not being a path to domestic default, it should be coupled with a firm commitment now to reduce the trillions of dollars in unfunded entitlement liabilities that loom in the United States' near future.

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[25] Reinhart, Carmen M and Rogoff, Kenneth S. "Banking Crisis: An Equal Opportunity Menace." 17 December 2008.
[26] United States Treasury. "Net Purchases of U.S.Treasury Bonds & Notes By Major Foreign Sector: Foreign Official Institutions, Other Foreigners, and International & Regional Organizers."
[27] "Trouble Ahead for US Treasury if Foreigners Keep Selling." Research Recap. 21 January 2009.
[28] U.S. Department of Treasury Net Purchases of U.S. Treasury Bonds & Notes By Major Foreign Sector: Foreign Official Institutions, Other Foreigners, and International & Regional Organizations.
[29] "U.S. 5-yr CDS at record wide of 69.5 bps - CMA Datavision." *Reuters*, 19 January 2009.
[30] Congressional Budget Office Director's Blog. "Institute of Medicine of the National Academies plus a related thought." 13 October 2008.

<u>Much of the "stimulus" in this bill is poorly targeted or poorly timed to help the economy in 2009 or 2010</u>

Although the Democrats have stated their goal is to create a short-term program that "provides immediate stimulus to help create jobs," [31] it isn't at all clear that everything in this bill will stimulate short-run demand. Using a stimulus bill as a down-payment on longer-term priorities is like imagining how you are going to redecorate the house while you are still fighting the fire that is burning it down. When you are fighting a bad economy, focus on fixing the economy.

Prominent examples of this type of spending from H.R. 1 include:

- $70 million for a support computer for climate research;
- $650 million to support a failed digital television transition program;
- $100 million for lead paint abatement; and
- $75 million for smoking cessation.

<u>Much more of this spending bill is a down-payment on long-run policies advocated by Congressional Democrats</u>

Perhaps the most surprising thing about this spending bill is that instead of thinking carefully about which projects would get the most people working or have the greatest impact on the economy, Democrats in Congress has used it as cover to fund long-standing priorities that would not have otherwise received funding for lack of political support. Speaking of the health-related portions of the legislation after passage out of the Ways and Means Committee, California Democrat Pete Stark said, "We accomplished more today than in the last eight years."[32] This bill creates new entitlements that will be very hard to rescind funds from. Such programs can only be paid for in the long run by massive cuts in spending elsewhere in the budget or tax increases. Assuming the money in this legislation can be spent quickly and with very little of the waste associated with government contracting (both dubious propositions), these projects will provide jobs for as long as the federal funds are available, but will have no lasting effect on the economy once those funds dry up. This will create political pressure to continue these programs beyond their current appropriations dates.

Prominent examples from H.R. 1 include:

- Expansion of Federal funding of Title I education funds;
- $500 million for climate research at NASA;
- $10.5 billion to reduce the earnings threshold for the child tax credit, lowering the incentive to work which the credit was designed to provide;

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[31] "House Plan Offers 'Noticeable Impact,'" *Washington Post*, 27 January 2009, page A07
[32] "Relief Seen for Jobless and States in Health Plan," *New York Times*, 27 January 2009

- Potentially creating a new health entitlement by providing a $25 billion subsidy to unemployed workers receiving COBRA; and

- Expanding tax credits to Americans who currently have $0 or negative tax liability.

What exactly is the link the Administration believes exists between spending on school districts and economic growth? Romer and Bernstein assume multipliers for government spending as high as 1.57, but it is not clear that funding community service projects for seniors will have any multiplier effect. Certainly enormous innovations in science and technology have resulted from the government's investment in military and space programs, but can the same be said for the government's spending on agriculture or health care, and can we really pinpoint specific multipliers for dollars spent in these areas? Mark Zandi of economy.com estimates the multiplier on "general aid to State Governments" is 1.59. Does this one multiplier for all uses of funds imply that one dollar spent on congestion relief in a major city has the same impact as one dollar spent clearing trails at state parks? Obviously those activities have different economic returns, but in the models used to estimate the effect of this legislation, all state spending is assumed to have the same multiplier.

The true threats to our economy lie in the housing and the financial sector

Any amount of money Congress authorizes right now has to be looked at in the context of the overall assistance the economy is going to require in the next 12 to 24 months. Any money appropriated for fiscal stimulus is separate and in addition to the money that will be needed to support the financial sector before the end of the year. A paper from the International Monetary Fund found that the Japanese's embarking on ambitious and expensive public works and fiscal stimulus projects in response to financial crisis in the 1990s was ineffective because they failed to focus "on improving the balance sheet of the financial and corporate sectors."[33]

Congress is debating spending over a trillion dollars (including the interest costs) now on projects that could make only a small difference in our short-run economic performance, while the troubles in the financial sector continue.

Goldman Sachs predicted that banks will record an additional $1.1 trillion in losses by the end of 2009, roughly the same amount of losses experienced by banks in 2008. Foreclosures, one of the driving forces behind losses at many banks, are expected to rise throughout 2009. In addition, as the economy continues to deteriorate, losses on credit cards and auto loans will continue to grow, leaving the banks with very little capital to cushion against further losses or lever in the form of loans. Last year Congress provided $700 billion for the Bush Administration to use to support the financial sector. An emerging consensus suggests this money will not be enough.
Several ideas for supporting the financial sector and the housing sector are being discussed in Congress. These proposals are beyond the scope of this paper, however, all plans under consideration have two things in common: they are necessary, and they are expensive. One historical review puts the standard costs of banking fiascos to the domestic government at 10-20% of GDP.[34]

[33] "Fiscal Policy for the Crisis," Staff Position Note, International Monetary Fund, 29 December 2008
[34] Boone, Peter and Johnson Simon. "To save the banks we must stand up to the bankers." *Financial Times* 26 January 2009

Two prominent Democratic members of Congress recently admitted as much. Senator Charles Schumer of New York said, "The advantage is you come clean and the banks don't die a death of a thousand cuts. The bad news is it's going to take an initial outlay of $3 trillion to $4 trillion." His colleague on the House side, House Financial Services Committee Chairman Barney Frank, said of the TARP funds: "I don't think many people at the top of the Treasury or the Fed thinks this is the last amount of money they're going to need to deploy."[35] Vice President Biden revealed that the new Treasury Secretary is preparing a report "as to whether or not he thinks that 350 is enough."[36] Media reports reveal the Administration is considering starting a "bad bank" as a repository for bad loans held by banks, and citing Administration sources speculating the government would have to raise one to two trillion dollars to pay for it.[37]

A trillion dollars is a lot of money to waste. Spending political capital to support an ineffective trillion dollar stimulus when further funds will be surely be needed to target the true problems in the economy is a dangerous approach to help our economy.

Conclusion

Fiscal stimulus will not be enough to rescue our economy. Members of Congress acknowledge today that further attempts to support the financial sector are going to be both necessary and expensive. Without any fiscal stimulus the 2009 deficit is already projected to be 8.3% of GDP. It is irresponsible to pledge hundreds of billions of taxpayer dollars that we don't have on potentially wasteful projects when we know that problems in the financial sector will require a serious, expensive, long-term federal intervention to fix.

[35] Montgomery, Lori and Cho, David. "Obama to Decide Soon Whether to Add to Bailout: As Banks' Situation Worsens, Some Lawmakers Say $700 Billion Rescue Won't be Enough." *Washington Post*, 24 January 2009.
[36] Shear, Michael D. "Banks May Need More, Biden Says: Treasury to Report on Use of Bailout." *Washington Post*, 26 January 2009.
[37] Enrich, David, Hilsenrath, Jon and Solomon, Deborah. "New Bank Bailout Could Cost $2 Trillion." *Wall Street Journal*, 29 January 2009.